THE POSITION OF THE SECURITIES MARKETS.

BY ALLEN GREY HOYT.

In the expressive but exaggerated language of Wall Street, the condition of our securities markets is summed up in the comment that "bonds are unsalable." Without exaggeration, it may be said that the demand for investment securities is at the lowest ebb we have experienced since American finance was firmly established upon a gold basis in 1896.

The situation is reflected in the quotations governing the markets. Investment issues, practically without exception, are selling at prices from ten per cent. to fifteen per cent. lower than those which ruled two or three years ago. Finding it impossible to market their securities, one syndicate after another has been dissolved. As the bonds thus released have been thrown upon the market by tired holders who were glad to liquidate their interests even at a severe sacrifice, they have found a level eight to ten points below the prices at which it was anticipated they would be taken by investors. And many of these syndicates have been sponsored by leading bankers whose position is predicated upon their ability to presage the probable trend of the investment markets.

Some months ago, railroads and other corporations found it impossible to dispose of their long-term obligations except at extremely onerous rates, and therefore fell back upon the expedient of issuing high-interest-bearing short-time notes. Finally, the markets became gorged with this class of securities, and belated borrowers, even though railroads of high standing, if in exigent need of funds, were compelled to accept rates which would have been spurned by second-rate industrial corporations a year or two ago.

The results of the sharp depreciation in the market value of securities have a serious aspect. Banking institutions with large holdings have been compelled to write off severe losses as, from time to time, they have been obliged to appraise their resources. The depreciation in the assets of some of the large insurance companies reaches millions of dollars, and every investor who owns a bond knows that the value in exchange of his security is much less than it was two or three years ago.

The conditions now prevailing in our markets cannot be ascribed wholly to local influences. Similar conditions are to be found in every other important financial centre. To illustrate the situation in Europe it is only necessary to refer to the sharp decline in the prices of German Imperial Bonds, French Rentes and English Consols. The significant fact stands forth that there has been a world-wide rise in the price paid for the use of capital, and the downward movement in the quotations for bonds has been the necessary corollary. At the lower prices they yield the increased return which capital now demands.

The causes that have brought about the appreciation in the general interest rate are numerous, but a few of them stand out prominently. Within a decade we have had two extremely costly wars, waged under the expensive methods of modern warfare. More recently, two important cities have been practically destroyed by earthquake. The republics of South America have been withdrawing gold from active use in Europe, as a basis of bank credits, to their own confines, where its function becomes a passive one of maintaining a steady ratio for a heretofore fluctuating paper currency. We have had lavish expenditures by municipalities both in the United States and abroad, largely conducted with borrowed funds, while Colonial and Government loans, issued for various purposes, have absorbed enormous sums from the markets.

A far more important factor than any of these influences has been the industrial activity enjoyed by practically all of the leading commercial nations. The foreign trade of nine States increased last year by no less than $1,500,000,000 over 1905. After having suffered depletion on account of wars, catastrophes and other extraordinary circumstances, the markets have not been in a position to supply the enormous demand for capital for industrial purposes. Commerce throughout the world has

been advancing with rapid strides during the past few years, and, gaining momentum as it proceeded, it has now attained such proportions that it is straining almost to the breaking-point the resources of credit and capital upon which it depends.

Of the causes which have brought about this unprecedented industrial activity, the increasing output of gold is probably the most important. A large percentage of the metal raised has found its way into the money stocks of the world with a resulting rise in prices and at present the index number shows the general level to be at practically its highest point.

Rising prices, with the prospect of a steady demand, spell profits to the manufacturer and the merchant. In order to take advantage of the situation, the producer, as well as the distributor, increases his plant and enlarges his business in every way possible. His need for capital and credit increases proportionately.

In every industrial venture there are usually two classes of persons associated. One class supplies capital as partners in the enterprise. They take the risks, and, if the venture succeeds, they take the profits. The capitalist of the other class advances his funds merely as a lender or creditor. His risk is minimized, and he desires only the repayment of the amount he advanced, with interest. In a corporation, these two classes of investors, to use the term broadly, become the shareholders and the bondholders.

A period of expansion in business is accompanied by innumerable opportunities for investment by each class. As the rates paid to those who invest as creditors mount upward, so must the inducements offered with new issues of stock become by so much the more attractive, for any investor is offered a free choice as to which form of security he will select. Moreover, many stocks partake more or less of the nature of a bond; especially is this the case with certain preferred shares. Dividends of a specified rate are reasonably assured; and one buying such stocks knows that the risk of market depreciation is not appreciably greater than that incurred in buying long-term bonds. Therefore, large issues of either form of security absorb a certain amount of funds that would be available for investment in the other class.

We have seen an exemplification of the operation of these influences in the recent history of our railroad financing. As

bonds and notes have been issued at constantly increasing rates, so have stocks been put forth at lower and lower prices.

The continuous inflow of gold into the money stocks of the world, during the past five or six years, has, of course, largely augmented bank reserves, and the volume of credit supported by these reserves has been enlarged by perhaps four or five times the amount of the metal increase. But the stimulation of trade resulting from the higher prices has so largely increased the demand for credit that interest rates have risen sharply, notwithstanding the increased reserves.

The managers of our railroads, however, have had much more to contend with than the increase in the price of capital. In order to handle the great volume of traffic pressed upon them, they have had to make enormous improvements without being able to reimburse themselves by higher tariffs. Public policy has demanded better terminal facilities, additional safety appliances and other improvements which do not directly increase income. The cost of operation and of improvements, on account of increasing wages and advancing costs of materials and equipment, has risen rapidly.

While laboring under the stress of these economic difficulties, the railroads were then called upon to face political onslaughts of a serious character. With or without justification, our Federal and State Governments developed a paternalistic attitude, which threatened to interfere with profitable operation even under more favorable conditions than those with which the roads were confronted.

Wall Street jumped to the conclusion that this political movement was the entire explanation of the difficulties with which the investment markets were suffering, just as in London, the City attributed the decline in Consols to the socialistic tendencies indicated in the programme of the recently elected Liberal Party,—quite overlooking the fact that securities wholly unaffected by these influences, such as municipal issues, for instance, instead of advancing as might have been expected on account of the diversion of funds from the threatened securities, showed the same declining tendency as those directly influenced.

However, to turn to our railroads again, the anti-corporation activity on the part of our legislatures did disturb confidence to some extent and by so far adversely affected security values.

The rise in wages, instead of contributing to a proportionate increase in the savings of our wage-earners, has resulted in the development of extravagant tastes and habits; the accumulation of surplus funds available for investment has not increased correspondingly with the enlarged earning-power of the individual. Moreover, real estate, mining and other ill-conceived speculative ventures which always thrive during periods of prosperity, have resulted in the dissipation of tremendous sums.

The rapid increase in the erection of buildings and the development of suburban properties have contributed to raise the rates paid on real estate mortgage loans, and thus to attract funds that would otherwise be invested in securities. All of these tendencies have contributed to the extraordinary rise in the wages of capital and have left the markets practically bare of investment funds.

The situation finds many of the railroads in a serious dilemma. Some of them have great improvements but half completed, and they need funds with which to go on with the work. The condition of the investment markets makes it impossible to obtain these funds except at extremely high rates. On the other hand, to discontinue their undertakings will also entail enormous expense on account of the rapid deterioration of materials and tools, as well as of the incomplete work, itself, if abandoned in its present condition. Moreover, the improvements will not become productive until finished, and meanwhile the roads can expect no return upon the amount already invested in them. In view of the fact that many of these betterments are absolutely necessary to enable the railways to handle the traffic, the managers who have in charge the financing of the roads naturally feel that any political agitation which augments the difficulties with which they have had to contend is dangerous; that it may bring disaster to the railway corporations, and, if to them, inevitably to the country in general. In fact, it is difficult to imagine conditions under which the potential danger of restrictive legislation would be greater than at present.

What, then, does the future hold in store? Evidently, the same influences which are causing the disaffection of the markets will work their cure. The process may or may not be accompanied by complete prostration. High money rates directly affect the profits of every form of industry. High wages and

high costs for raw material also are making inroads on net earnings. The general expansion of credit is beginning to make collections slow. All indications at present point to a recession in business.

Those railroads which are in a position to retrench are beginning to do so. Other corporations are undertaking few improvements or extensions unless they can be financed out of earnings. Many weaker corporations, finding it increasingly difficult to secure the necessary credit to carry on their business, are facing the possibility of bankruptcy. That there will be a general slowing down sufficient to relieve the strain on capital, there can be little doubt. Whether or not the retrograde movement will go further and result in complete stagnation is, of course, an open question. Undoubtedly, if at this critical juncture we were to experience a serious crop failure, if our corporations were to be handicapped by unwise legislation, or if we were to face any crisis, even though one which under ordinary circumstances we could safely weather, the effect would be extremely serious.

The wavering attitude of our stock-markets shows that the speculator is finding it exceedingly difficult to come to any conclusion as to the future. Presumably on account of the probable decline in the interest rate for capital, stocks will sell at prices which will show a smaller return upon the investment than that yielded at current quotations, but the same influences which will cause the lowering of interest rates may go so far as to bring about a reduction in dividends, and thus the outlook for stocks is much confused.

The interest on well-secured railroad bonds, however, notwithstanding the possible enactment of paternalistic or restrictive laws, will continue to be paid. Even in the event of a period of industrial depression, on account of the economic necessity of transportation, the danger of default is slight. Therefore, there seems little reason to doubt that a decline in the price of capital will have the effect of raising quotations for conservative railroad issues well above those now prevailing.

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